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TAGS: ECON EFIN ELAB PGOV IT KPRP
SUBJECT: ITALIAN CHAMBER OF DEPUTIES APPROVES BILL TO IMPROVE FINANCIAL MARKETS OVERSIGHT

REF: A) 04 ROME 406; B) 04 ROME 2630

SUMMARY

¶1. On March 4, the Chamber of Deputies approved, and sent to the Senate for consideration, the reform of Italy's fragmented financial markets oversight system. The government promised the reform one year ago in the wake of the Parmalat scandal. The current bill addresses conflict of interest between banks and companies; requires banks to provide a prospectus for the bonds they sell; and strengthens Italy's securities market and company audit regulator, Consob. The bill makes a half-hearted attempt on accounting fraud, but not enough to address EU concerns over a 2001 law weakening accounting fraud sanctions. A separate bill implementing the EU Market Abuse Directive, already approved by the Chamber of Deputies, could be approved by the Senate in April. This bill does not address accounting fraud. End Summary.

One Year Later - A Step Closer to Reform

¶2. On March 4, the Chamber of Deputies approved the reform of Italy's fragmented financial markets oversight system and sent the bill to the Senate for consideration. Political disputes delayed approval of the bill, originally presented to Parliament in February 2004 by then-Finance Minister Tremonti. The initial dispute was between Central Bank (CB) Governor Fazio and Tremonti, who sought to clip the CB's regulatory powers and limit Fazio's Governor-for-life term. Fazio came out on top, when Tremonti was forced to resign over other matters in summer 2004 (Ref B).

Central Bank Powers Intact

¶3. The Chamber of Deputies-approved text is largely consistent with that approved in committee, with the important exception of leaving untouched the powers of the Central Bank. The bill is consistent with the government's position that the term of the CB governor should not be addressed within the market oversight reform and that the CB should retain oversight of competition (anti-trust) policy in the banking sector. The Senate is also expected to leave the CB authority untouched, when the Senate takes up the bill.

Securities Market Regulator Strengthened

¶4. The bill provides tough oversight on conflict of interest between banks and companies and requires banks to provide potential retail investors with a prospectus for bonds the banks sell. Consob, Italy's securities market regulator, gains powers in the supervision of auditing firms, while the financial police (Guardia di Finanza) will work more closely with Consob. The bill introduces a new category of crime - "nocumento" - fraud affecting a number of investors greater than 0.5 percent of Italy's population (about 289,000) or investment holdings greater than 0.5 percent of GDP (about USD 7.5 billion). The bill also puts limits on the credit that banks can extend to major shareholders (75 percent of the value of the shares the investor owns) and requires that company boards include an outside member who represents minority shareholders.

Little New on Accounting Fraud;
EU Still Likely to Act.

¶5. The bill raises the maximum sentence for false accounting from one-and-one-half to two years. However, there is still no penalty for company directors and board members who prepare, approve, or disseminate false balance sheets involving an amount below five percent of the company's pre-

tax profits, despite the opposition's efforts to include such provisions. (Note: The Berlusconi government passed a law in 2002, which eased penalties for certain types of corporate accounting fraud and made it harder to prosecute such offenses. At that time, PM Berlusconi was facing criminal charges for false accounting; but the case was suspended after the law passed. End Note.)

¶6. The European Court of Justice (ECJ), however, has Italy's law on corporate fraud in its sights. Specifically, after the government loosened accounting fraud rules in 2002, the ECJ reviewed the claim that the law violates EU statutes. The Advocate General (AG) to the ECJ issued an opinion in October 2004 that sections of the 2002 law are incompatible with EU legislation. The ECJ should rule on the case in the first half of 2005. Historically, in four out of five cases, ECJ rulings have agreed with the AG opinion. In sum, the new bill makes a half-hearted attempt on accounting fraud, but not enough to address EU concerns over the 2002 law. It seems reasonable to assume that EU institutions would also review any new legal provisions on accounting fraud, too.

Next Steps

¶7. On March 16, the Senate Finance and Industry Committees jointly took up the market oversight bill passed by the Chamber of Deputies. Among changes expected in the Senate are the restoration of pension fund oversight to Covip, the pension regulator, and the creation of a bond-risk rating system to inform investors better. Any changes to the bill means it would then return to the Chamber of Deputies for reconsideration. Senate Committee Chairmen hope to have approval by the full Parliament prior to the August recess.

Slow Implementation of EU Market Abuse Law

¶8. The Senate has not yet approved a separate bill transposing the EU directive on market abuse into Italian law, which was approved by the Chamber of Deputies on December 2, 2004. The EU deadline for member states to adopt the EU directive was October 12, 2004. According to Senate schedules, floor debate on the bill should start April 5, with possible approval by end-April. The law strengthens Consob by increasing 1) staff (from 450 to 600), 2) investigative powers (to require magistrates/law enforcement to cooperate with regulators more), and 3) sentences, to up to six years for some financial crimes (except accounting fraud). The bill also gives Consob access to the Centrale dei Rischi, the Central Bank archive of confidential accounting documents from financial institutions. The bill as passed by the Chamber of Deputies would effectively implement the EU market abuse directive.

Market Oversight Reform, EU Market Abuse Laws a Package
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¶9. Taken together, the Security Market Reform bill and the bill to transform the EU Market Abuse Directive into national law, if passed and adequately enforced, substantively improve Italy's securities market oversight. Provisions in the two laws are mutually reinforcing. For example, to effectively exercise the new authorities in the Oversight Reform law, Consob will need the increased staffing authorized in the EU Market Abuse law. Indeed, elements of the global reform package originally proposed by former-Finance Minister Tremonti can be found in each of the two laws. However, insufficient penalties for corporate fraud are still a weakness in Italian legislation. EU pressure on Italy could help close this loophole.

Comment

¶10. To be fully effective, Italy's security market oversight reform should both create a set of coherent laws and regulations, as well as ensure that regulators have the authority, independence, skills, and resources to enforce the rules. The final package of laws will make an important contribution toward this ideal, but its real impact can only be measured by the vigor with which regulatory authorities enforce the law to prevent market abuse and corporate fraud. End Comment.

Sembler

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